APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CIVIL ACTION
NO. H-89-2818

UNITED STATES OF AMERICA

Plaintiff,

VS.

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND, AND BAY RIVER
COMPANY, INC.

Defendant.

MEMORANDUM

The United States of America brought this action against Fidelity and Deposit Company of Maryland ("Fidelity") and Bay River Company, Inc., ("Bay River") to recover amounts due under two distilled spirits bonds for unpaid distilled spirits taxes. Fidelity contests the amount due under the bonds and asserts that the United States should be estopped from any recovery owing to the United States' failure to act. The United States allegedly did not inform Fidelity of Bay River's poor financial standing. Pending before the Court is a Motion for Summary Judgment (Instrument No. 11) submitted by the United States. The United States has also filed a Motion to Dismiss (Instrument No. 22) the Counterclaim for Declaratory Judgment filed by Fidelity. Also pending before the Court is Fidelity's Motion for Summary Judgment (Instrument No. 17). The Court has considered the motions, the responses, and the applicable law, and is of the opinion that the United States' motion for summary judgment should be granted and Fidelity's motion for summary judgment should be denied. The issues raised by Fidelity's

Counterclaim are effectively disposed of by the grant of the United States' motion. All other motions before the Court are moot.

I. STATEMENT OF FACTS

The United States filed suit against Bay River Company, Inc. ("Bay River") seeking approximately 1.6 million dollars for unpaid distilled spirits taxes that had accrued from October 1985, through April 1988. On July 3, 1990, the Court entered a default judgment against Bay River for the unpaid spirits taxes plus interest and statutory additions allowed by law. The Court decreed that Bay River was entitled to credit for any payments made on behalf of Bay River pursuant to any surety bonds. *United States v. Fidelity and Deposit Co. of Maryland,* No. 89-2818 (S.D.Tex. July 3, 1990). There are two surety bonds at issue in this action.

Fidelity issued a bond to Bay River for the face amount of $350,000.00, on October 5, 1984 ("1984 bond"), and on November 17, 1986, Fidelity issued a strengthening bond ("1986 bond") in favor of Bay River for an additional $600,000.00. Pl.'s Motion for Summ. J. Exhibits A and B. The United States now seeks to recover from Fidelity the amounts under the bonds issued by Fidelity to secure the obligations of Bay River to the United States.

As noted below, a surety's liability for withdrawals may be limited by the terms of the bond. Fidelity has paid the United States $100,000.00, under the terms of the Original Bond but argues that the express terms of the 1984 bond allow for no further withdrawal liability.

The face of the 1984 distilled spirits bond is illuminating. The top right portion of the bond contains printed instructions to "Check applicable boxes." Under "1. OPERATIONS" no mark is apparent. A mark of "x" appears to the left of the printed instructions for "2. WITHDRAWAL BOND" and "3. UNIT BOND." In a large block imprinted "AMOUNT OF BOND" the amount of "$350,000" is typed. On the reverse side of the bond are four columns with the headings from left to right reading,

"NAME AND ADDRESS," "REGISTRY NUMBER," "OPERATION COVERAGE," and "WITHDRAWAL COVERAGE." In the operation coverage column "Warehousing and Processor" is typed, after which there appears the amount of $250,000.00." The "amount of coverage" noted at the very end of the operations column is "$250,000.00" and the amount for withdrawal coverage is "$100,000.00."

Fidelity argues that the terms of the 1984 bond clearly demonstrate that its withdrawal liability under that bond is limited to $100,000.00. The United States maintains that the full amount of the bond, $350,000.00, can be used as withdrawal coverage since the 1984 bond was clearly not an operations bond, because "OPERATIONS" had not been marked, but is both a withdrawal and unit bond.[1] Therefore, while $100,000.00 was clearly earmarked for withdrawal liability, the remaining $250,000.00 that appeared in as "OPERATION COVERAGE" section was in fact part of the unit bond coverage that could be applied to withdrawal liability.

Fidelity's defense to 1986 bond hinges on a different theory. Fidelity contends that the United States should be estopped from collecting on the 1986 bond because the government was aware that; (1) Bay River had continually experienced difficulty in complying with government regulations, (2) did not inform Fidelity of the violations, (3) make demand under the 1984 bond, or (4) take any action to collect the taxes. The United States responds noting that Fidelity cannot assert an entitlement to estoppel when Fidelity never contacted the government in evaluating the feasibility of issuing the 1986 bond and merely relied on the representations of Bay River and its President. Pl.'s Motion for Summ. J. at Ex. C., Interrogatories Nos. 8-10, and 18-20.

II. DISCUSSION

A. Summary Judgment Standard

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[1] A unit bond can cover both operations and withdrawal liability. 26 U.S.C. § 5173(d).

Rule 56(c) provides that "[summary] judgment shall be rendered forthwith if the pleading, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). A party seeking summary judgment bears the initial burden of informing the district court of the basis for its motion, and identifying those portions of the pleading, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, which it believes demonstrate the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 325 (1986). The moving party has the burden of showing that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law. *Williams v. Adams*, 836 F.2d 958, 960 (5th Cir. 1988). The burden is not on the movant to produce evidence showing the absence of a genuine issue of material fact. *See International Ass'n of Machinists & Aerospace Workers, Lodge No. 2504 v. Intercontinental Mfg. Co.*, 812 F.2d 219, 222 (5th Cir. 1987). A defendant who moves for summary judgment may rely on the absence of evidence to support an essential element of the plaintiff's case *Id.*

Once the movant carries this burden, the burden shifts to the nonmovant to show that summary judgment should not be granted. *See Celotex*, 477 U.S. at 324-25. A party opposing a properly supported motion for summary judgment may not rest upon mere allegations or denials of his pleading, but must set forth specific facts showing the existence of a genuine issue for trial. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256-57 (1986). Assertions unsupported by facts are insufficient to oppose a motion for summary judgment. *Williams v. Weber Management Serv.*, 839 F.2d 1039, 1041 (5th Cir. 1987). There must be evidence giving rise to reasonable inferences that support the non-moving party's position. *St. Amant v. Benoit*, 806 F.2d 1294, 1297 (5th Cir. 1987). Bare or mere allegations are insufficient. *Lodge Hall Music, Inc. v. Waco Wrangler Club, Inc.*, 831 F.2d 77, 79 (5th Cir. 1987).

In considering a motion for summary judgment, the district court must view the evidence through the prism of the substantive evidentiary burden. *Anderson*, 477 U.S. at 254. The evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor. *Id.* at 254. The inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. *Matsushita Electric Ind. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986). Summary judgment is inappropriate if the evidence before the court, viewed as a whole, could lead to different factual findings and conclusions. *Honore v. Douglas*, 833 F.2d 565, 567 (5th Cir. 1987).

B. The Applicable Law

1. The 1984 Bond

Fidelity argues that it is not liable under the 1984 bond having already tendered the full amount of the withdrawal coverage to the United States. The United States argues that the 1984 bond was also a unit bond allowing for an additional $250,000.00 used for operations coverage to be used for withdrawal coverage. Fidelity counters by noting that on the reverse side of the 1984 bond "$100,000.00" appears in the withdrawal coverage column and thus its liability is limited to that amount. The applicable bond statute reads in part:

> (a) Operations at, and withdrawals from, distilled spirits plant must be covered by bond. —
>
> > (1) Operations. — No person intending to establish a distilled spirits plant may commence operations at such plant unless such person has furnished bond covering operations at such plant.
> >
> > (2) Withdrawals. — No distilled spirits (other than distilled spirits withdrawn under section 5214 or 7510) may be withdrawn from bonded premises except on payment of tax unless the proprietor of the bonded premises has furnished bond covering such withdrawal.

(d) Unit Bonds. — Under regulations prescribed by the Secretary, the requirements of paragraphs (1) and (2) of subsection (a) shall be treated as met by a unit bond which covers both operations at, and withdrawals from, 1 or more bonded premises which could be covered by the same operations bond under subsection (b).

26 U.S.C. § 5173(a)1, (a)2 and (d).

A unit bond may be used for plant operations and/or withdrawal coverage. 26 U.S.C. § 5173(d); *see U.S. v. Reliance Ins. Co.*, No. 86-7028, 1987 WL 16307 (E.D.Pa. August 23, 1987), *aff'd*, 845 F.2d 1018 (3rd Cir. April 21, 1988) (table).

Fidelity relies heavily on *U.S. v. Reliance Ins. Co.*, for the proposition that where the reverse side of the bond contains figures in both the operations and withdrawal coverage categories those figures do not demonstrate the existence of a unit bond, but merely demonstrate the existence of two distinct bonds and the liability for each is limited to the amounts listed. Fidelity asserts that the reverse side of the bond clearly states the coverage for each category. In reality *Reliance* has a much narrower holding and squarely supports a ruling in the governments favor.

In *Reliance* the government sued a surety for the excise tax obligations of a bankrupt distiller. The issue before the *Reliance* court was whether the surety bond was a unit bond capable of covering both operations and withdrawals. There the face of the bond noted that it was an operations bond and a withdrawal bond; the Court later ruled that although the box denoting unit bond coverage was also marked it was clearly a falsification since the box was marked with a different typestyle. The Court then deduced that since the bond was not a unit bond it was merely two distinct bonds, one for operations and one for withdrawals. The amount of coverage for each component was obvious from the reverse side of the bond.

In the case at hand the bond is clearly marked, it is both a withdrawal and unit bond. There has been no allegation that

the 1984 bond has been tampered with. The total amount of the bond is $350,000.00. On the reverse side the bond indicates that there is $100,000.00 for withdrawal coverage. On the front side of the bond, however, the "OPERATIONS" box is not marked. The bond is clearly not an operations bond. The "UNIT BOND" box is marked with an "x" indicating that some $250,000.00 is allocated as a unit bond that allows for operation and/or withdrawal coverage. On the reverse side the bond indicates that there is $250,000.00 for operations coverage. The Court must enforce the instrument as written.

A surety may only arise out of an express contract. *A/S Hydraulico Works v. Fort Worth and Denver Railway Co.*, 483 F.Supp. 518, 521 (S.D. Tex. 1980). "The courts will enforce an unambiguous instrument as written; and in an ordinary case, the writing alone will be deemed to express the intention of the parties." *Sun Oil Company (Delaware) v. Madeley*, 626 S.W.2d 726, 728 (Tex. 1981). *See also Cherokee Water Company v. Forderhause*, 641 S.W.2d 522 (Tex. 1982); *Aetna Life and Casualty Company v. Gunn*, 628 S.W.2d 758 (Tex. 1982).

If an instrument has certain and definite meaning then it is not ambiguous and the Court must construe it according to its terms. *Coker v. Coker*, 650 S.W.2d 391 (Tex. 1983). This Court must ascertain the true intentions of the parties as expressed in the instrument. *Id.*

The admission of explanatory extrinsic evidence depends on whether the court finds as a matter of law that a written instrument is ambiguous. *Isbell v. Williams*, 738 S.W.2d 20, 24 (Tex. App. — Texarkana 1987, writ ref'd n.r.e.); *Reilly v. Rangers Management, Inc.*, 727 S.W.2d 527, 527 (Tex. 1987); *O'Shea v. Coronado Transmission Co.*, 656 S.W.2d 557, 561 (Tex.App. — Corpus Christi 1983, writ ref'd n.r.e.).

The interpretation of an instrument becomes a fact issue for the jury only when, after application of the pertinent rules of construction, there remains a genuine uncertainty as to which of two meanings is proper. *Harris v. Rowe*, 593

S.W.2d 303, 306 (Tex. 1979). This is so as Texas courts have repeatedly declared that the question of whether an instrument is ambiguous is one of law for determination by the court. *See e.g., R & P Enterprises v. LaGuarta, Gavrel & Kirk, Inc.*, 596 S.W.2d 517, 518-19 (Tex. 1980); *Coker v. Coker*, at 394.

There are other meanings of ambiguity. An instrument may be ambiguous if its meaning is "uncertain and doubtful." *Skyland Developers v. Sky Harbor Associates*, 586 S.W.2d 564, 568 (Tex.Civ.App. — Corpus Christi 1979, no writ); *Walter E. Heller & Co. v. Allen*, 412 S.W.2d 712, 718 (Tex.Civ.App. — Corpus Christi 1967, writ ref'd n.r.e.) (guarantor liability). A written instrument may be ambiguous if it is "difficult to comprehend or distinguish, [or] of doubtful import," as there is "doubt as to [its] true meaning." *See San Antonio Life Insurance Co. v. Griffith*, 185 S.W. 335 (Tex.Civ.App. — Fort Worth 1916, no writ); *O'Shea v. Coronado Transmission Co.*, 656 S.W.2d at 561; *see also Goff v. Southmost Sav. & Loan Ass'n*, 758 S.W.2d 822, 825 (Tex, App. — Corpus Christi 1988. writ denied).

The principal purpose of construction is to ascertain the intentions of the parties. Therefore, instruments must be construed from a "utilitarian standpoint bearing in mind the particular business activity sought to be served..." *Neece v. A.A.A. Realty Co.*, 322 S.W.2d 597, 602 (Tex. 1959); *see also Skyland Developers v. Sky Harbor Associates*, 586 S.W.2d at 570.

Courts must give effect to the objective, not subjective, intent of the parties as it is expressed in writing, as that intent control the instrument's construction. *Westwind Exploration, Inc. v. Homestate Sav. Ass'n*, 696 S.W.2d 378, 382 (Tex. 1985) (contract).

This Court must harmonize and give effect to ***all the provisions of the instrument*** *so that none of the writing will be meaningless. Chapman v. Orange Rice Milling Co.*, 747 F.2d 981, 983 (5th Cir. 1984); *Universal C.I.T. Credit Corp. v. Daniel*, 243 S.W.2d 154, 158 (Tex. 1951). If the provisions in the instrument appear to conflict, they should be adapted

to reflect the true intentions of the parties. *Ogden v. Dickenson State Bank*, 662 S.W.2d 330, 332 (Tex. 1983). This Court must give weight to each portion of the instrument unless there is an irreconcilable conflict. *Id.* Moreover, no single provision taken alone will be given controlling effect; rather, all provisions must be considered with reference to the whole instrument. *Coker v. Coker*, 650 S.W.2d at 393; *Bush v. Brunswick Corp.*, 783 S.W.2d 724, 728 (Tex. App. — Fort Worth 1989, writ denied.

To adopt Fidelity's argument that the bond is both a operations and withdrawal bond would vitiate the intent of the parties expressed on the face of the instrument. "UNIT BOND" was clearly marked. Since a unit bond can be used for both operations and withdrawal liability, the $250,000.00 can be used to secure the payment of tax obligations in this instance. Although the 1984 bond noted that operations coverage was $250,000.00, that coverage was secured by a unit bond for that amount. Inasmuch as it is undisputed that a unit bond may cover both operations and withdrawals the $250,000.00 unit bond initially designated for operations may also cover withdrawals. Fidelity is liable to the United States for $250,000.00 under the 1984 bond.

2. The 1986 Bond — The Defense of Estoppel

Fidelity asserts that the 1986 bond it issued should be void *ab initio* for the Bureau of Alcohol, Tobacco & Firearm's ("ATF") failure to disclose facts material to Fidelity's issuance of the strengthening bond. Fidelity asserts that ATF was aware that Bay River, among other things; (1) wrote checks that were returned for lack of sufficient funds, (2) was insolvent, and (3) was continuously in violation of federal statutes and regulations.

Equitable estoppel may be imposed against the government only in the most egregious situations. *See Heckler v. Community Health Services, Inc. of Crawford County*, 467 U.S. 51, 60-61 & 60 n.12 (1984). Statutes and regulations which are designed to direct government officers in the performance of their duties for the government's own protection do not create any obligation to the surety on the

bond. *United States v. Federal Ins. Co.*, 805 F.2d 1012, 1014 (Fed. Dir. 1986), *cert. denied*, 481 U.S. 1048 (1987); *see also United States v. Fulton Distillery, Inc.*, 571 F.2d 923, 928 (5th Cir. 1978).

"[O]nly by express agreement or statute can the Government assume the consequences of the neglect of its employees." *United States v. Fulton Distillery, Inc.*, 571 F.2d at 927 (footnote omitted). In *Fulton Distillery*, the Fifth Circuit found that the surety assumed the risk of the effect of negligent governmental conduct. 571 F.2d at 927 (quoting *Hart v. United States*, 95 U.S. 316, 319 (1877)). Additionally, the Court there found that "nothing in the legislative history of or the regulations accompanying the relevant statutory provisions suggests that Congress intended to reallocate risks . . . ." *Id.* at 928.

"The Government's neglect could not have constituted an act which increased the surety's risk and discharged [Fidelity] because the risk of neglect had already been allocated to the surety . . . ." *Id.* The Government owes no duty to a surety for its neglect in this instance.

Fidelity relies on dicta at the end of *Fulton Distillery*, for the proposition that where the government failed to act altogether there exists an egregious circumstance requiring estoppel. *United States v. Fulton Distillery, Inc.*, 571 F.2d at 928. It remains uncontroverted, however, that Fidelity did not communicate with the government while evaluating the feasibility of issuing the 1986 bond. Pl.'s Motion for Summ. J. Ex. C, Interrogatory No. 19 ("Identify all communications, written or oral, that defendant had with any representative of the Federal Government concerning Bay River Company, Inc.'s financial situation and/or suitability for a discharge bond, setting forth the time the communication took place, the parties thereto and the subject matter thereof. ANSWER: None." *Id.*) Under the seminal case on which Fidelity relies, *St. Paul Fire & Marine Ins. Co. v. Commodity Credit Corp.*, 646 F.2d 1064 (5th Cir. 1981), "if a surety fails to seek important information that is available to him, he cannot, in the absence of fraud, assert as a defense

ignorance of the facts which he should have known prior to the execution of the contract." 646 F.2d at 1072 (emphasis omitted). The United States asserts that had Fidelity investigated the information readily available to it it could have easily discerned Bay River's financial status. Yet, under *St. Paul Fire & Marine Ins. Co. v. Commodity Credit Corp.*, estoppel may still attach when the surety fails to investigate. 646 F.2d at 1070 n.5. There, the Fifth Circuit refused to charge St. Paul with discovery of the true state of affairs of industry custom even where no representative from the bonding companies approached the government directly for information. 646 F.2d at 1070-74.

However, unlike *St. Paul Fire & Marine Ins. Co. v. Commodity Credit Corp.*, "a surety has been on notice for 100 years that he assumes the risk of negligent governmental conduct" under the excise tax statutes. *United States v. Fulton Distillery, Inc.*, 571 F.2d at 927.

Additionally, *St. Paul*, can be distinguished as it pertains to the role of a surety with respect to Commodity Credit Corporation-sponsored loans and not to the relatively "explicit" area of law that guards the collection of government excise taxes. *see generally United States v. Fulton Distillery, Inc.*, 571 F.2d at 927. Fidelity is liable under the terms of the 1986 bond, the defense of estoppel will not lie in this instance.

III. CONCLUSION

This Court, having considered all other contentions presented, concludes, for the reasons set forth above, that Fidelity's motion for summary judgment should be denied and the United States' motion for summary judgment should be granted. The relief sought in Fidelity's counterclaim for Declaratory Judgment and Rescission has been resolved in favor of the United States. Fidelity is liable for $250,000.00 under the terms of the 1984 bond and for $600,000.00 under the terms of the 1986 bond.

SIGNED at Houston, Texas, this 25th day of September, 1992.

/s/ MELINDA HARMON

MELINDA HARMON
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

UNITED STATES OF AMERICA, *Plaintiff*	§	
v.	§	
FIDELITY AND DEPOSIT COMPANY OF MARYLAND AND BAY RIVER COMPANY, INC., *Defendants*	§	Civil No. H-89-2818

SUMMARY JUDGMENT AGAINST DEFENDANT FIDELITY AND DEPOSIT COMPANY OF MARYLAND

The plaintiff, United States of America, has moved this Court to enter summary judgment in the amount of $850,000.00 against Defendant Fidelity and Deposit Company of Maryland ($950,000.00 pursuant to liability on two surety bonds, less $100,000.00 credit for an amount previously collected from Fidelity and Deposit Company of Maryland under one of the two surety bonds). Based on the United States' motion and its attached Declaration and Supporting Memorandum, this Court is of the opinion that the said Motion for Summary Judgment should be granted. It is, therefore,

ORDERED, ADJUDGED and DECREED that plaintiff, United States of America, have and recover judgment against Defendant Fidelity and Deposit Company of Maryland in the amount of $850,000.00, for unpaid distilled spirits taxes.

All parties are ORDERED to pay their own costs and attorney's fees.

DONE this 25th day of September, 1990.

/s/ MELINDA HARMON
United States District Judge